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Message Text

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DEPARTMENT PASS TREASURY AND FEDERAL RESERVE

E.O. 11652: N/A
TAGS: EFIN, GW
SUBJECT: AMENDMENT TO GERMAN BANKING LAW

REF: BONN 3091, PARAGRAPH 7, AND BONN 829

1. SUMMARY. ON FEBRUARY 20 THE BUNDESRAT PASSED THE MUCH DISCUSSED AMENDMENT TO THE GERMAN BANKING LAW. THE NEW LAW SHOULD BECOME EFFECTIVE ON MAY 1, 1976, PRESUMING IT IS SIGNED BY THE FEDERAL PRESIDENT. THE OBJECTIVE OF THE LEGISLATION IS TO IMPROVE THE SECURITY OF BANK DEPOSITS AND TO INSURE THE OBSERVANCE OF NECESSARY PRECAUTIONS TO PREVENT CASES SIMILAR TO THE COLLAPSE OF HERSTATT, WHICH PROVIDED THE IMPETUS TO THE LEGISLATION. THE MAJOR PROVISIONS OF THE AMENDMENT INCLUDE:
A) A TIGHTENING OF LIMITATIONS ON LARGE BANK CREDITS;
B) AN EXPANSION OF REPORTING REQUIREMENTS AND INCREASED POWERS FOR THE BANKING SUPERVISORY AUTHORITY;
C) A REQUIREMENT THAT INDIVIDUAL BANKS HAVE AT LEAST TWO LEGALLY RESPONSIBLE MANAGERS; AND
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D) THE INTRODUCTION OF A TEMPORARY CLOSURE

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PROVISION FOR BANKS JUDGED BY THE SUPERVISORY AUTHORITY TO BE IN DIFFICULTIES.

2. INITIALLY THE GOVERNMENT HAD CONSIDERED INTRODUCING A MANDATORY DEPOSIT INSURANCE SYSTEM BUT DECIDED AGAINST THIS WHEN GERMAN BANKS ESTABLISHED THEIR OWN VOLUNTARY INSURANCE SCHEME. END SUMMARY.

3. THE NEW AMENDMENT TO THE GERMAN BANKING LAW WAS PASSED BY THE BUNDESRAT ON FEBRUARY 20 AND IS NOW AWAITING SIGNATURE BY PRESIDENT SCHEEL. THEN, AFTER BEING PUBLISHED IN THE FEDERAL LAW GAZETTE (WHICH IS EXPECTED TO TAKE PLACE IN MARCH), THE AMENDMENT WILL BECOME EFFECTIVE ON THE FIRST DAY OF THE SECOND MONTH FOLLOWING ITS PUBLICATION (IN THIS CASE MAY 1). THE AMENDMENT WAS PREPARED BY THE FEDERAL GOVERNMENT AND SUBMITTED TO PARLIAMENT AFTER THE FAILURE OF THE HERSTATT BANK IN JUNE 1974, WHICH CAUSED A CONSIDER-ABLE DECLINE IN CONFIDENCE IN THE GERMAN BANKING SYSTEM AT HOME AND ABROAD. THE MAJOR PROVISIONS OF THE NEW LEGISLATION ARE AS FOLLOWS:

4. LIMITATIONS ON LARGE BANK CREDITS

ALL LARGE BANK CREDITS (DEFINED AS THOSE EXCEEDING 15 PERCENT OF THE BANK'S EQUITY CAPITAL) ARE TO BE LIMITED TO EIGHT TIMES THE BANK'S EQUITY CAPITAL. THE FIVE LARGEST CREDITS ARE TO BE LIMITED TO THREE TIMES THE CAPITAL, AND ANY SINGLE CREDIT TO 75 PERCENT OF THE CAPITAL. IN CALCULATING LIMITATIONS FOR ALL LARGE CREDITS (TO EIGHT TIMES THE CAPITAL) CREDIT COMMITMENTS WILL NOT BE INCLUDED; AND GUARANTEES AND OTHER WARRANTIES AS WELL AS CREDITS RESULTING FROM THE PURCHASE OF BILLS ELIGIBLE FOR REDISCOUNTING AT THE BUNDESBANK WILL BE CALCULATED AT ONLY HALF OF THEIR VALUE. THE SUPERVISORY AUTHORITY MAY EXEMPT INDIVIDUAL BANKS OR GROUPS OF BANKS FROM OBSERVING THE ABOVE LIMITATIONS IF THE SPECIAL CHARACTER OF THEIR BUSINESS JUSTIFIES SUCH ACTION. IN CASES REGARDING LIMITATIONS FOR LARGE CREDITS THE BANKS ARE GIVEN 5 YEARS TO REDUCE UNCLASSIFIED

SUCH CREDITS TO THE ABOVE LIMITATIONS. ADDITIONALLY IN CASE OF LIMITATIONS FOR ALL LARGE CREDITS TO EIGHT TIMES THE CAPITAL THE BANKS MUST REDUCE AMOUNTS EXCEEDING THE NEW LIMITATIONS BY 20 PERCENT EACH YEAR.

IN THE OLD VERSION OF THE BANKING LAW LARGE CREDITS WERE LIMITED ONLY INSOFAR AS ALL LARGE CREDITS WERE NOT TO EXCEED HALF OF ALL LENDINGS OF A BANK, AND NO SINGLE

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LARGE CREDIT TO EXCEED THE BANK'S EQUITY CAPITAL.

5. REVISED REPORTING REQUIREMENTS AND INCREASED SUPERVISORY POWERS

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REPORTING REQUIREMENTS HAVE BEEN TIGHTENED WITH REGARD TO BANK REPORTS TO THE BANKING SUPERVISORY AUTHORITY, REPORTS OF AUDITORS AND BANK PARTICIPATION IN OTHER BANKING INSTITUTIONS. THE NEW LEGISLATION ALSO EXPANDS THE POWER OF THE BANKING SUPERVISORY AUTHORITY TO REQUEST FURTHER SPECIFIC INFORMATION ON A BANK'S BUSINESS. ADDITIONALLY, THE AMENDMENT PROVIDES THE SUPERVISORY AUTHORITY WITH THE RIGHT TO MAKE SPECIAL AUDITS WITHOUT BEING REQUIRED TO GIVE REASONS, AND IT IS NOW EMPOWERED TO WITHDRAW A BANKING LICENSE IF HALF OF THE EQUITY CAPITAL OF A BANK HAS BEEN LOST OR IF, IN THREE SUCCESSIVE YEARS, MORE THAN 10 PERCENT OF THE EQUITY CAPITAL HAS BEEN LOST IN EACH YEAR.

6. TWO MANAGERS PRINCIPLE

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UNDER THE AMENDED LAW APPLICATIONS FOR BANK LICENSES WILL NOW BE REJECTED IF THE APPLICANT BANK DOES NOT HAVE AT LEAST TWO LEGALLY RESPONSIBLE MANAGERS ("FOUR EYES PRINCIPLE"). APPLICATIONS FROM POTENTIAL LICENSEES IN THE LEGAL FORM OF A SINGLE OWNERSHIP (EINZELKAUFMANN) WILL NO LONGER BE GRANTED. EXISTING
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INSTITUTIONS IN THIS LEGAL FORM WILL BE PERMITTED TO CONTINUE.

7. TEMPORARY CLOSURES

THE AMENDMENT GIVES THE SUPERVISORY AUTHORITY THE RIGHT TO ORDER THE TEMPORARY CLOSURE IF A BANK IS JUDGED BY THE SUPERVISORY AUTHORITY TO BE IN FINANCIAL DIFFICULTIES. SUCH A CLOSURE IS DESIGNED TO PROVIDE TIME FOR THE EXECUTION OF MEASURES TO PREVENT DAMAGES TO THE BANK'S CREDITORS AND THE BANKING COMMUNITY, OR AT LEAST, TO KEEP SUCH DAMAGES AT A MINIMUM. IF THE CLOSURE DOES NOT HELP TO SAVE THE BANK, THEN THE SUPERVISORY AUTHORITY ALONE IS EMPOWERED TO APPLY FOR BANKRUPTCY PROCEDURES. PREVIOUSLY, ANY CREDITOR OF THE BANK COULD INITIATE BANKRUPTCY PROCEDURES.

8. DEPOSIT INSURANCE SCHEME

THE PARLIAMENT REFRAINED FROM INTRODUCING A MANDATORY DEPOSIT INSURANCE SYSTEM AFTER THE FEDERAL ASSOCIATION OF GERMAN BANKS ANNOUNCED THE INTRODUCTION OF A PRIVATE DEPOSIT INSURANCE SCHEME, THE SO-CALLED "DEPOSIT GUARANTEE FUND" (EINLAGENSICHERUNGSFOND). THE LEGISLATORS CONSIDERED THIS SCHEME TO OFFER SUFFICIENT SECURITY FOR BANK DEPOSITS. THEY ALSO REFRAINED FROM MAKING MEMBERSHIP OF BANKS IN THE NEW PRIVATE INSURANCE SYSTEM OBLIGATORY SINCE THE BULK OF BANKS HAD ALREADY VOLUNTARILY JOINED THE SYSTEM. ANOTHER REASON FOR NOT DOING SO WAS THAT LEGISLATORS FELT THE INSURANCE SYSTEM SHOULD NOT BECOME AN INSTRUMENT, AS THEY EXPRESSLY STATED IN THEIR REPORT TO THE PARLIAMENT, "TO DISCIPLINE UNDESIRED BUT SOUND OUTSIDERS" (I.E., POTENTIAL COMPETITORS, INCLUDING FOREIGN BANKS). ALTHOUGH MEMBERSHIP IN THE INSURANCE SYSTEM IS NOT OBLIGATORY IT WILL, AGAIN QUOTING THE REPORT, BE "A NOT UNIMPORTANT CRITERION FOR THE BANKING SUPERVISORY WHEN DECIDING ON THE GRANTING OF A BANKING LICENSE". MORE-OVER, BEFORE ISSUING A NEW LICENSE THE SUPERVISORY AUTHORITY MUST HEAR FROM THE BANKING ASSOCIATION ON THE APPLICATION.
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9. THE DEPOSIT INSURANCE SCHEME, AS ESTABLISHED BY THE BANKING ASSOCIATION, PROVIDES FOR COVER OF DEPOSITS OF ANY NON-BANK DEPOSITOR IN AN AMOUNT UP TO 30 PERCENT OF THE EQUITY CAPITAL OF THE INDIVIDUAL BANK. OFFICIALLY THE SCHEME IS NOT YET IN EFFECT SINCE THE FEDERAL CARTEL OFFICE IS STILL EXAMINING CERTAIN OUTSTANDING QUESTIONS OF COMPETITION BETWEEN BANKS (CONNECTED WITH THE BANKS' COOPERATION IN THE INSURANCE SCHEME). HOWEVER, IN THE BANKRUPTCY OF THE PFALZ-KREDIT-BANK (SEE BONN 829) THE FUND WAS ALREADY USED TO COVER DEPOSITS OF NON-BANK CUSTOMERS. BEFORE THE ESTABLISHMENT OF THE NEW INSURANCE SYSTEM THERE WAS ONLY THE SOCALLED "FIRE BRIGADE FUND" OF THE BANKS WHICH COVERED DEPOSITS IN AN AMOUNT OF UP TO DM 20,000.
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